

US ENDING STOCKS ARE A MAJOR BURDEN



RECORD QINGDAO PORT STOCKS



US CROP EXPECTED TO REACH 22 MILLION BALES DESPITE TOUGH START



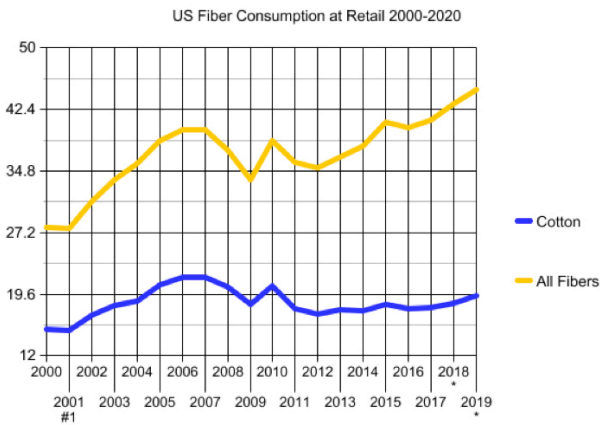
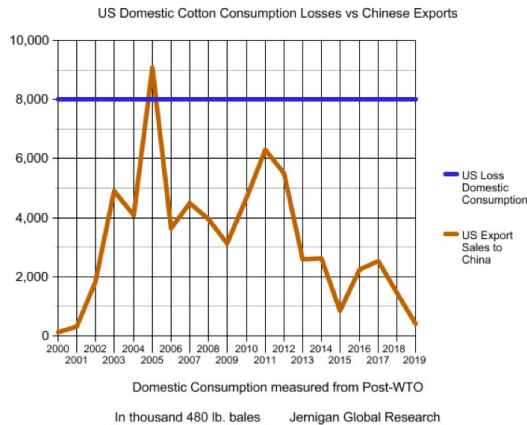
US/CHINA TALKS WILL RESUME



# JERNIGAN GLOBAL

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## US COTTON EXPORT CRISIS AS 2019/2020 SEASON BEGINS DUE TO LACK OF INVESTMENT IN REGIONAL SUPPLY CHAIN



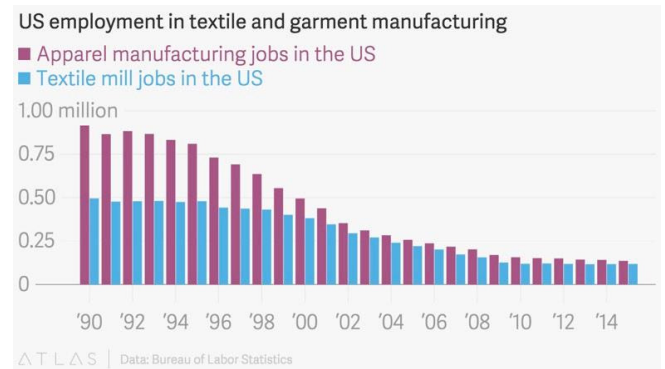
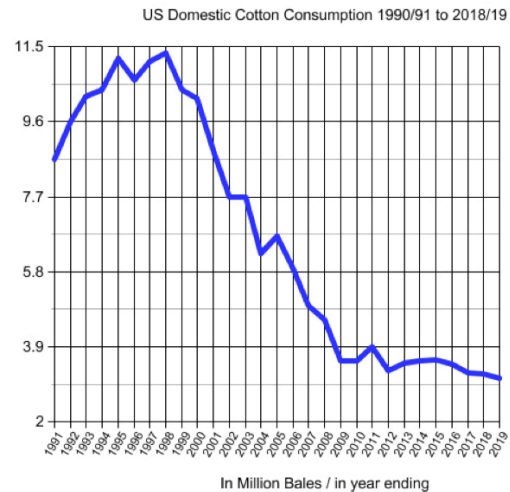
The US is the largest cotton exporter in the world, and in 2019/2020 it is being challenged by the Brazil and African Franc Zone export axis. At the same time, the China/US trade conflict has denied the US access to China, the largest export market. The trade war has also taken a toll on China's textile and apparel industry and contributed to a sharp contraction in Chinese cotton use. These issues are presenting considerable challenges for US cotton exports. In 2000, corporate America began to outsource the majority of the US manufacturing base, including the domestic textile and apparel industry. The arrival of the "China Price" soon resulted in a collapse of the manufacturing sector. There was little strategy or long-range planning regarding the impact of this decision on US workers, farmers, or the US national security interest. US cotton

consumption in 1997/1998 was 11,329 million bales, and today the industry is barely holding 3.0-3.1 million bales. US export sales to China did increase, but have been a major disappointment. US export sales to China from 2000 to 2017 have averaged only 3.495 million bales annually, thus, more than eight million bales of domestic cotton use have been lost, with export sales to China falling 4.5 million bales short. In only one year, 1995, was the tradeoff a winner when China purchased 9.089 million bales. It was very costly to the US treasury through the Step 2 export subsidy for that to be accomplished. Overall, the full ramifications of the collapse of the domestic consumption base are just now being felt, as cotton appears to have lost its clout in Washington, and export subsidies have been limited by WTO and political will.

The chart above tells the story well. When the trade dispute with China began, the US cotton industry was silent, expecting that conditions would quickly return to the status quo. Now, one year later, it's clear there will be no return to the status quo for US cotton exporters or for the Chinese textile and apparel industry. Supply chains are moving, and the domestic market is showing clear signs of slowing. The new world will be difficult for both cotton exporters and for the Chinese textile industry. New investments are being made and additional capacity is coming online in the textile chain. For example, Weiqiao Textiles, one of the world's largest cotton spinners, is opening a new automated intelligent spinning and weaving production line. The new facility will reduce labor cost by 90% and produce much higher quality yarns and fabrics. New investments in functional fabric are being announced. How long it will take for domestic demand to rebound is a critical question, since export prospects in the near-term will be weaker, which presents a challenge. Without access to the Chinese market, the US cotton industry faces serious challenges in increasing export demand. This is also due to the Chinese market and increased competition from Brazil, which is producing a higher quality cotton.

The greatest impediment to US cotton export prospects is the lack of a strong domestic or regional consumption base. The current trade conflicts have their roots in the unwillingness of many US corporations to return their supply chains to the US. For those corporations, the issue is not just labor cost but also the unwillingness to make the capital investment in automation needed to be competitive. Instead, numerous companies that are moving out of China are simply trying to replicate the Chinese model in Vietnam, Mexico, or other cheap labor locations. Regarding textiles and apparel, no significant, large-scale new investment is occurring, despite the availability of sewbots and other automation technology. The view continues to be short-term margins and profits, without the investments. Asset light remains the model. Compare this strategy to that of Chinese companies that continue to make large investments in the latest technology. The current US administration has been advocating for the relocation of manufacturing back to America, but it has provided no long-range plan or incentives for this to occur. Textile and apparel policy and leadership has been missing in action with no strong advocates, not a single brand or retailer, willing to make the commitment to re-shore manufacturing operations, or some part of it, in a large-scale way. The US textile industry has been decimated, as there is only one small ELS spinner left

in the US. If a company wants to produce an all-US apparel product, it is limited to the lower count yarns. It is very surprising there is no plan to maintain at least a nominal supply chain for the better products. Fabric and dyeing capacity are very limited. Cotton t-shirts are now the US specialty. Even Japan has remained with a small high-end supply chain, as well as the premier selvedge denim brand. This is something the US cotton industry will have to address, or the cotton industry will shrink.



Regional trade agreements have had limited success. CAFTA-DR has been successful, but has only reached a portion of its potential because of the poor governance of the local governments and lack of security. These factors have inhibited new investment, and loopholes in the agreement have allowed Chinese man-made fiber fabrics to play a major role. CAFTA-DR has a US market share of 7.7%, with exports of textiles and apparel expected to reach 8.6 billion USD in 2019. Only 4.475 billion of that total is cotton apparel that is directly linked to US cotton fiber, yarn, and fabric. CAFTA-DR demand for US cotton yarn and fabric is responsible for much of the remaining 3.1 million bales in US domestic cotton consumption.

Mexico/NAFTA consumption has been stagnating since China joined the WTO and undercut the region. Cotton use reached 2.4 million prior to WTO, and today it is 1.9-2.0 million bales. New investment has been lacking due primarily to security issues. A new plan for economic zones has failed due to the lack of security. Mexico has been a steady source of US cotton export demand, with annual US imports near a million bales. Collectively, the regional US, Mexico, CAFTA-DR consumption base accounts for approximately four million bales of annual demand for US cotton, or only about 36% of the post-WTO domestic US cotton demand.

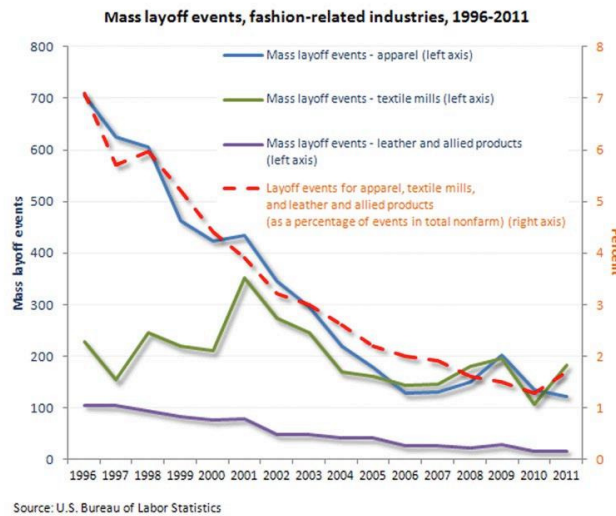
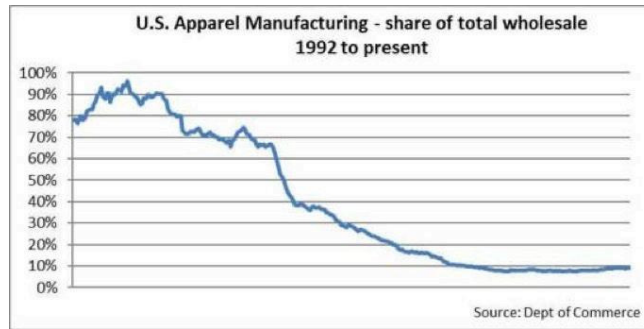
The potential exists to rebuild a smaller US consumption base focused on the segments of the industry that can be heavily automated. This could be expanded to rebuild the regional supply chains involving Mexico, Central America, Columbia, Peru, and the Caribbean. Such a plan will take either government or private leadership from the US, ideally both. At present, that leadership is woefully missing, as is the corporate commitment for the necessary investments. In 2017, it appeared that Chinese companies might lead the way on this, but that has not happened. Since one of the largest Chinese groups did not follow through on an earlier MOU, and overall Chinese investments in the US are shrinking. With US cotton production near 19-20 million bales, the US is faced with the burden of exporting an additional 15-16 million bales annually, and the burden is increasing with each bale produced above this level. The problem seems obvious considering the US has exported more than 15 million bales only twice. The record was set in 2005/2006, with the Step 2 payments

at 17.673 million bales, and with China accounting for a record 9.089 million bales of that volume. Then, in 2017/2018, 15.847 million bales were exported, with 2.526 million bales going to China. US exports in 2018/2019 are likely to be near 14.2 million bales, with 1.5 million bales going to China. This illustrates the crisis at hand. Without Chinese demand, 13-15 million bales of exports is a challenge, and even larger volumes will require a sizeable crop shortfall elsewhere or expanded world trade. The task is further complicated by the need for Brazil to export 8.5-9.0 million bales,

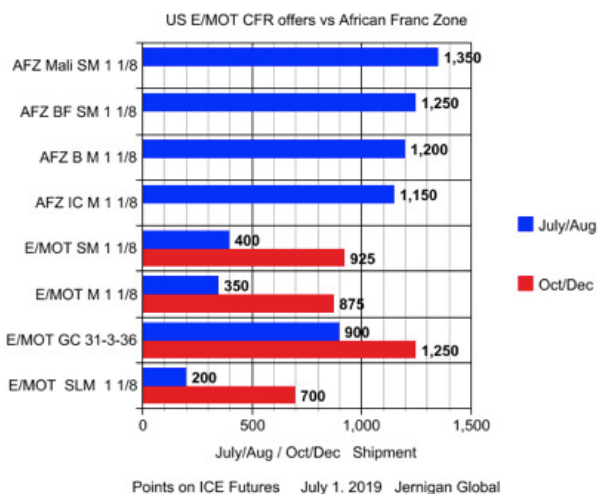
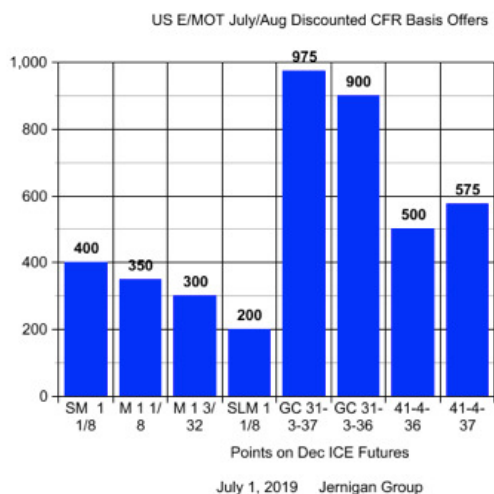
double its export volume of 2017/2018. The issue is that 2019/2020 world trade outside of China is expected to show limited growth. The USDA is actually forecasting a shrinking in demand of near a million bales in total world trade, including China. World trade is forecast to expand just over 3.7 million bales. This is what makes the slowdown in Chinese demand so serious.

US 2019/2020 export sales are reflecting these conditions. As of June 20th, the US has forward sales of only 4,057,600 running bales, compared to 6,514,300 bales at the same time a year ago. If the forward sales are reduced to reflect the China sales that are in doubt without a solid trade deal, then forward

sales drop to only 2,579,600 running bales. This represents sales 60% below a year ago. It was shocking to see that 2019/2020 sales in the week ending June 20th totaled only 48,600 running bales. The US faces a crisis in meeting its export targets, but with brisk Chinese import demand and access to that market the worst case scenario will be avoided. With weak Chinese demand and no access to that market, US stocks will build and the crisis will increase.



## MERCHANTS' DISCOUNT 2018 CROP'S REMAINING US STOCKS AS SEASON DRAWS TO A CLOSE



The final month of the 2018/2019 season has begun, and some merchants are aggressively offering US old crop stocks near the July/Dec futures discount. The discounts are not universal, and the Cotlook Index remained actually inverted. However, the discounts were surprising. E/MOT SM 1 1/8 offers for immediate shipment could be found at a 500-550-point discount for October-December shipment out of a few shippers on Monday. This was followed by the issuance of notices against the July contract, even at the discount that was prevailing. This behavior suggests additional export cancellations are likely, and some merchants simply want to liquidate old crop inventories. As of Friday, very aggressive CFR Asia export offers (China) of MOT were still in circulation for July-August shipment. SM 1 1/8 was offered at 400 on Dec, which reflected a 450-point discount to new crop and a 500-point discount to a Green Card 31-3-36 offered for the same period. M 1 1/8 offers could be found at 350 points on Dec, which was over 700 points below the Cotlook quoted basis level. SLM 1 1/8 was offered at 200 points on Dec. These weak offers corresponded with the lack of support in spot July. The discount of these offers to 2018 crop African Franc Zone top grades, such as a Benin Kaba/s 1 1/8, are at new records. This suggests major quality concerns by spinners for the cotton quality they are receiving on type offers.

Similar weak demand is evident in domestic demand from merchants, due to one of the weakest US FOB basis levels in years in the month of July. The FOB basis for a 41-4-34 ranges from 300 off October in the Southeast to 675 points off October in Texas. The

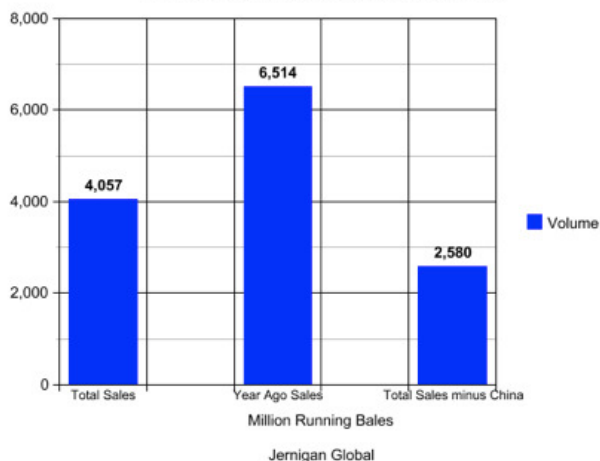
only cotton trading is in Texas at the cheap basis. The weakness has attracted additional export offtake, but it also illustrates the lack of confidence in demand and merchants' long basis position. The discount is not as steep in the Green Card offers. This weakness contrasts with one of the firmest African Franc Zone 2018/2019 basis in years. The SM 1 1/8 Mali is offered at 1400 points on Dec, while a Middling 1 1/8 is offered at 1200 points on. The inversion of the normal spread relationships illustrates just how the China/US trade war and the extreme poor quality of the 2018 US crop has changed trade patterns.

The US will end the 2018/2019 season with very burdensome stocks that are weighing on the nearby basis. As of June 20th, the US has sold 4,066,812 running bales that had not been shipped. The market now expects a sizeable volume of these sales will be cancelled or rolled forward into the 2019/2020 season. At least 2.0 million bales will be rolled into 2019/2020 export sales or the sales canceled. 2018/2019 carry over could be near 5.0 million bales or more, and much of these stocks are lower grade. This has created a burden for the Trade to carry these stocks into the 2019/2020 season. Approximately 1.0 million bales of the remaining unshipped 2018/2019 US export sales are at risk of being canceled due to the high prices at which they were sold. Late opening of letters of credit are occurring. Outside of China, the largest risk of sales appears in Turkey, Indonesia, and Bangladesh, where more than 1.3 million bales have been sold but are unshipped to these three countries. The Bangladesh market is very weak, with spinners reducing operations due to the unprofitability of yarn at the current spreads.

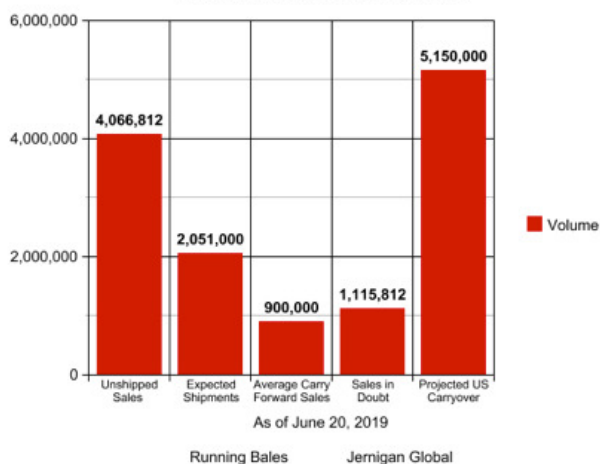
392,900 bales of 2018/2019 US upland cotton have been sold but are unshipped to Bangladesh. This is larger than normal for this market, and with some spinners still needing nearby supplies, it suggests difficulty getting their letters of credit open.

At near five million bales of carryover, this is the highest US carryover in ten years. It was 2008/2009 when the US faced a similar burden, unable to reach export targets even with a small crop. One of the reasons in that period was that domestic consumption fell by 25% from the previous year, increasing the export target. The US in 2008/2009 had a crisis due to the fact it had no domestic or regional consumption base. Ten years later the industry faces the same crisis after making no effort to address the issue. Expectations were that Chinese imports would be the answer, but this has proven an inadequate solution. The US burden to export has come at a time when Brazil has emerged as the second largest cotton exporter in the world. During the past several years the quality of the Brazilian crop has improved, and Brazilian cotton now competes directly with US cotton in every major export market.

US 2019/20 Export Commitments as of June 20, 2019



US 2018/19 Export Sales/Shipment Status



The high leaf, lower color grade of the 2018 US crop has extended the discount of a Strict Middling and Middling type to the Green Card offers. The abundance of the Strict Low Middling and lower color grades, or 41, has also extended the discount of a 41-4-36 Green Card to 300 points for 2019 crop E/MOT, which is more than double the normal discount. The near five million bales of carryover, which consist of mostly 41 and below color grades and high leaf, is a significant burden for exports. The shortfall in the US quality and smaller Australian crop has left the high end, longer staple supply tight. This is a key driver in the record premium of African Franc Zone high grades. The quality of the 2018 crop was good, and ginning and picking techniques have improved, so buyers have been willing to overlook the remaining contamination issues.

## UNSOLD QINGDAO CHINESE PORT STOCKS AT RECORD LEVELS

Qingdao Port is one of the top ten ports in the world, the 4th largest container port in China, and also the 2nd largest foreign trade port. Approximately half of all cotton imports enter China through the port. The port, located in Shandong, has an extensive network of bonded warehouses used to store a host of commodities. A commodity is stored in an approved warehouse in a special customs area, while waiting for the payment of duties and VAT tax. Once the commodity is purchased by a Chinese customer, it can quickly be processed and delivered. This practice has been popular for cotton, since it allowed merchants the

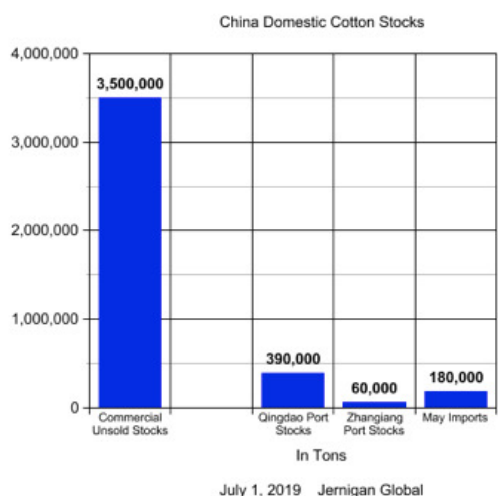


ability to provide Chinese customers with just-in-time delivery. During the periods of robust cotton import demand, the practice was used extensively by mills and merchants alike. Once the cotton is shipped to a bonded warehouse in the port it is quite expensive to move it out to another port. Thus, the cotton becomes generally committed to be sold in China. Only in a few rare instances have conditions changed so dramatically that cotton had to be moved.

US and Australian cotton have traditionally been the two principal growths placed in the bonded warehouses because of their popularity, but Indian, Brazilian, and West African are also warehoused at the port. It has become common for local traders in Qingdao to place stocks in the bonded warehouses so as to service local mills, to play the market and take positions. The high demand for Australian high grades has resulted in a large volume of Australian to move directly to bonded warehouses where it enjoyed steady offtake. Last season, much of the Australian crop moved to China, with a sizeable portion moving first into these bonded warehouses. The very large volume of the 2018 crop Australian was carried forward into 2019, and a sizeable block of Indian cotton moved into the warehouses in March and April 2019. 2018 Brazilian cotton moved into the warehouses as well. A block of US cotton was caught in the warehouses prior to the 25% tariff, which meant those stocks became quite expensive, with the exception of mills with processing quota.

Current unsold stocks at Qingdao port are estimated at 350,000-390,000 tons, which is at the estimated capacity. It is likely that many of the small positions held at the ports were not hedged, indicating these positions have accumulated sizeable losses. Demand for the port stocks has been very slow during the past 60-90 days. The near capacity stocks are very rare for the month of July when stocks are normally at their lowest point. An additional 60,000 tons of imported cotton is in bonded warehouses at the Zhangjiagang port. Since much of the port stocks were accumulated, the spread between imported cotton and local prices has narrowed. Presently, the Cotlook A Index, when adjusted for VAT and import taxes, is at near a 800 RMB a ton discount to the nearby ZCE cotton futures and 1100 RMB or more discount to the China Cotton Index, a 5 to 7 cents a lb. discount. When the A Index is adjusted to the sliding scale import price, the discount to the cash index is erased. Ginners in southern Xinjiang are offering discounts that also narrow the premium of imported cotton. The PCC in Xinjiang is reported to have experienced very poor demand over the past 60 days, with few sales. Some private ginners have tested the market with discounts but have not found solid bids. The largest demand has been for Reserve stocks that are trading at discounts to cash index and ZCE futures. The average price at the Reserve auction on June 26th was 12,957 RMB a ton, or 84.93 cents a lb., which was at a discount to all imported offers. The overall worry for the large unsold cash position in domestic cotton is the approaching new crop harvest and the need to repay outstanding loans.

China cotton imports in May reached close to a brisk 180,000 tons, and total August-May imports have reached 1,710,000 tons (7.856 million bales). These imports, plus the very burdensome unsold domestic stocks, provide a very adequate supply for spinners. Pressure is building to move the bonded warehouse stocks, with sellers offering discounts. The combination of these stocks could impact second-half Chinese cotton import demand, which comes on top of the weakness in Chinese cotton consumption. Traders took some relief from the sharp rally last week in ZCE futures, as the market held out optimism over weekend US trade talks.



## INDIAN MONSOON EXPANDS AS ACREAGE LEVELS IN DOUBT

The Indian monsoon has arrived as far north as Rajasthan and Madhya Pradesh. However, the rainfall totals have generally been very light and without the intensity of the normal monsoon. Daily rainfall last week in the crucial states of Gujarat and Maharashtra rarely exceeded 20-25 mm. Given the subsoil moisture deficits and the prevailing temperatures, these rains are not sufficient. It appears the net return and lateness of the monsoon has growers in Gujrat switching from cotton to groundnuts. It has been reported that growers have purchased only 3.0-3.5 million packets of cottonseed, which is down about 40% or more from the 4.5-5.0 million packets sold by this point in 2018. Groundnut prices have been very firm. It has a lower cost of production and provides extra incomes from the sales of the fodder. It is also a shorter season crop with a cycle of only 20 weeks. 2018 groundnut production in Gujarat totaled only 6.21 MMT, down from 7.56 MMT the previous season. Some estimates are that cotton acreage could be down 10-15% in the key state of Gujarat.

Planting of the 2019 crop remains slow, but in Gujarat growers have accelerated planting, since the cyclone

rains boosted soil profiles. As of June 24, 767,070 hectares had been planted in the state, which is far above normal. So far, the follow up rains from the Cyclone have been light. In Maharashtra, little cotton has been planted, as soil moisture levels remain critical. Planting has not yet started in Telangana as well.

Indian consumption is being maintained by growth in cotton apparel exports and continued brisk export shipments of cotton yarn through May. The steady level of demand that has been maintained to China has been surprising. In May, China imported 198,000 tons of yarn and India accounted for 49,700 tons, which represented a 11% increase over year ago. Vietnam was the top supplier. Indian mills have continued to buy imported styles in light volume. Indian cotton yarn exporters shipment prices to China in May were down sharply, which confirmed that spinners were able to compete despite the high current price of domestic Indian cotton prices. Domestic prices have been maintained at near 83 cents for a Shankar-6 1 1/8 ex-gin, as arrivals remain very light. This continues to suggest the lower production estimates will be confirmed.

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## AUSTRALIAN NORTHERN TERRITORY HARVEST BEGINS; IS THIS THE NEXT COTTON BELT?

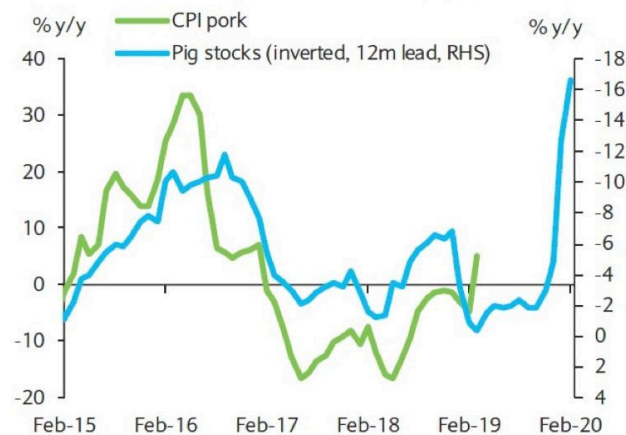
The harvest of the small Northern Territory cotton crop is getting underway. Cotton was planted this season at Tipperary, which is 160 kilometers south of Darwin. Approximately 70 hectares were planted, with 50 hectares of it irrigated and 20 hectares of dryland. The crop has performed well, with dryland yields an impressive 5-6 bales a hectare, and irrigated production hitting 10 bales a hectare. To the west in the Ord, approximately 350 hectares of irrigated acreage was planted. Cotton is beginning to expand in the region, and a gin is being discussed. Currently the cotton has to be trucked all the way to Queensland for ginning. Lots of NSW growers have been reviewing the region and considering establishing farms there because of the reliable water supply. The entire northern “Top End” in the Northern Territory and Western Australia has huge potential for the development of a new Australian farm

belt. However, major limitations exist. One key limitation is the fact that the region is very remote with little infrastructure and few developed water assets outside of the Ord. Native title to land can be an issue in some areas, and the Northern Territory government is also an inhibitor, as it appears to focus on its own path with investment from China and has a very limited budget.

The 2019 winter season has been cold in New South Wales with no rain. Many fear the cold winter suggests reduced hopes of pre-planting rains. For now, most export interest appears focused on China and Australian cotton stored in the bonded warehouses. The high grades, Good and Strict Middling, appear in tight supply at origin. The current forecast has only a few light showers possible in the near-term.

## WILL AFRICAN SWINE FLU CHANGE THE DYNAMICS OF CHINA TRADE IN SECOND HALF 2019?

FIGURE 3  
Rapid increase in pork prices on declining pig stocks



Source: Wind, Barclays Research

The African Swine Flu could play a much larger role in influencing US/China trade and Chinese domestic apparel demand than any other single event. In China’s opaque and secretive system of governance, in which the state is supreme and any failure has to be covered up or misrepresented, a massive crisis can spread and reach epidemic levels before the truth is known.

The African Swine Flu has no cure or vaccine, and the

only solution is the destruction of the animal. Pork is China’s number one protein source, and they produce and consume more pork than any country in the world. Regarding the scale of the swine flu, Rabobank states, “It’s historic; there’s never been anything like this in the history of modern animal production. And it’s a frightening situation only in that there is no current control.” China has officially reported losses of near 20% of its herd, but private estimates suggest that losses have been covered up and could actually be closer to 40-50% of the herd. To completely eradicate the disease will take years. The size of the Chinese herd and demand are larger than that of the rest of the world, so normally, pork trade is limited and China depends on domestic production.

The replacement of the pork losses will require most of the rest of the world surplus plus additional chicken and beef imports. Currently, China has showed no signs of panic. However, it has quietly purchased a record volume of Brazilian pork and other proteins, and record amounts of Australian beef. It currently has a 62% duty on US Pork imports, and last week banned imports from Canada. These moves have left the country unprepared for the shortage that lies ahead, according to some analysis.

J. Kyle Bass, a well known US hedge fund manager, believes the pork crisis and the import demand for meat protein will force China to reach a trade deal with the US



as a way to have access to US pork. Of course, imports could always be allowed by the state trading companies that can be granted duty-free access. The shortage of protein has already showed up in inflated retail prices that have affected consumer spending patterns. Consumer

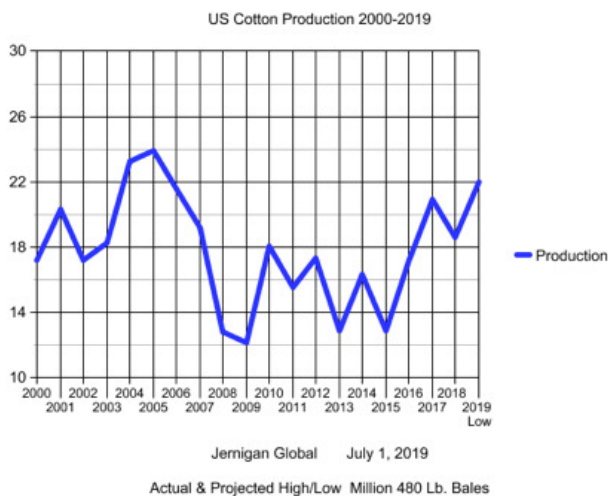
spending on apparel, appliances, and other products has turned weak due to an increase in spending being diverted to food. Wage growth has also ended in most areas, which is further impacting consumer spending patterns.

## CHINA POLYESTER PRICES RALLY SHARPLY AHEAD OF TRADE TALKS

**P**olyester staple prices rallied sharply last week in China, which was driven by two factors. First, speculation the meeting of Xi Jinping and US President Trump would result in a trade truce and a path forward on an agreement. Second, as we have feared, the recent sharp drop in polyester prices into the 45-46 cent a lb. range stimulated increased consumption of polyester fiber at the expense of cotton and other fibers. At one point, PSF was at more than a 37% discount to Viscose fiber, and a 50% discount to cotton. Spinners took up nearby needs at these discounts, which allowed prices to recover easily. The rally was focused on polyester

staple fiber and not all products, yarns, or raw material. The average PSF price reached highs of 8200 RMB a ton (53.75 cents a lb.), which reflects over a 6% increase in the last 30 days. Smaller gains occurred in POY, DTY, and FDY. Polyester filament prices experienced much more limited gains. PTA prices, one of the two main raw material in polyester staple fiber, rallied sharply in the domestic market, lead by large gains in PTA futures. PTA import prices, in contrast, gained only 1-2%. ZCE. Cotton futures also rallied sharply on speculation ahead of the trade talks.

## USDA SLIGHTLY LOWERS US COTTON ACREAGE AND YEILD POTENTIAL ABOVE WASDE ESTIMATES



**T**he USDA June planted acreage report set off widespread controversy in corn, as it forecast that US farmers would plant 3% more corn than a year ago, despite the record flooding in the key producing states. The USDA immediately said it would resurvey acreage for the August production estimates. In cotton, no surprises as planted acreage declined by 58,000 acres from the March estimate to 13.770million acres. The USDA also issued a supplementary report that showed

the percentage of the planting intentions that were not actually planted on the date of the survey. In cotton, this was 16.1% or 2.217 million acres. No comment on harvested acreage or yield was made. A review by region suggests that total harvested acreage will fall to near 11.862 million acres, down from 12.54 million acres in the June WASDE estimate. This reflects failed and prevented acreage in Texas, the Southeast, and the Mid-South. The final harvested acreage could be even lower. The average yield has been estimated in the WASDE at a very low 842 lbs. We believe this will eventually have to be adjusted much higher into the 875 to 925 lb. range, given the moisture profiles. This would provide a US crop of 21.62 to 22.859 million bales based on a harvested acreage of 11.862 million acres. A further 500,000-acreage reduction in harvested acreage with an average yield of 900 lbs. would provide a crop of 21.3 million bales.

The acreage estimates did capture the increased acreage in the Mid-South, where acreage increased to 2.280 million bales, up 295,000 acres from last year, and 40,000 acres from the March report. However, a portion of this acreage was prevented from planting due to floods, and we estimate harvested acreage in the

region at 90%. In Texas, planted acreage was reduced 150,000 acres to 7.150 million acres from the March estimate and 600,000 acres from 2018. Prevented and failed acreage may reach 15-20%, reducing harvested acreage to 5.720 million acres. In a bit of a surprise, Pima acreage was increased by 20,000 acres from the

March estimate to 275,000 acres.

Overall, the US crop has the potential to produce from 21.62 to 22.859 million bales, which will place a tremendous burden on exports, as we discussed earlier.

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## ETHIOPIA: NEW GLOBAL SOURCING HOTSPOT EXPERIENCES AN ATTEMPTED COUP

China has invested billions upon billions building infrastructure in Ethiopia and establishing it as a low-cost manufacturing center with a heavy emphasis on textiles and apparel. As companies continue the model based on the lowest cost labor locations, Ethiopia has become popular after Chinese loans built the infrastructure. Addis Ababa, the capital and largest city in Ethiopia, resembles a Chinese city with lots of modern skyscrapers thanks to Chinese investments. China built the major roads and the first metro system in sub-Saharan Africa. Between the government loans and the huge investment by Chinese business groups, both state-owned and private, John Hopkins China center estimates the total Chinese commitment has reached



130 billion USD. The new nickname for the country is the China of Africa. Ethiopia apparel exports to the US have soared 90% from January-April.

Despite the economic growth, the country experienced an attempted coup Saturday June 22nd when a hit squad lead by

a regional security chief broke into a political meeting and killed the regional President and advisor. In Addis Ababa, an army chief of staff was killed in his home by his security officer. Since then over 250 arrest have been made, and the country was without internet last week as China appeared to shut it down in order to help the government track down all those involved in the attempted takeover. No disruptions to export shipments of textiles or apparel were reported.

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## ICE FUTURES AGAIN FOCUSES ON CHINA/US TALKS AT G-20

The center of all attention last week was the Saturday meeting in Japan between Xi Jinping and President Trump. The Chinese domestic polyester market and ZCE's cotton and PTA futures both rallied sharply ahead of the meeting in hopes of at least a trade truce. Prior to meeting with Trump, Xi Jinping issued a serious of statements in which he attacked the rich countries for destroying the world's trading system. His statement seemed quite out of touch, even absurd, considering China has some part in the decimation of much of the



manufacturing capacity in the US and Europe after joining the WTO. The world continued to add to the stakes of a successful meeting as investment banks forecast major hurdles for global growth if the trade war continues. UBS forecast that the failure to reach a deal would lead to a .75-point reduction in the Global

GDP over the next six quarters. Such a development would certainly not be positive for global cotton consumption.

The global spinning sector has become increasingly nervous and has reduced their willingness to extend forward coverage any further. More and more evidence indicates the extremely weak polyester staple fiber prices have boosted demand at the expense of other fibers. The trade war is beginning to expand in its influence, as the US attempts to monitor and halt transshipments in order to avoid the tariffs. The trade war and China's changing political environment are rapidly moving supply chains, which is increasing unemployment in China and creating weakness in consumer spending. The four major South Korean groups that led the manufacturing revolution in China are pulling out. Samsung, Hyundai, KIA, and LG Electronics have all announced plant closures. LG has moved some production back to South Korea. Hyundai halted production at its Beijing plant. The Chinese textile and apparel industry was not prepared for a domestic slowdown, with many groups in the middle of new investments. The overcapacity of the industry is a significant problem that is reducing cotton consumption and idling plants in China. These plants will not automatically scale back up production if a trade agreement is reached.

The second concern is that, even with a path forward on a trade agreement, China is likely to buy a much smaller volume of US agriculture products than was discussed a year ago. In the case of cotton, China's domestic market is overstocked. First, there's the record level of unsold 2018 Xinjiang cotton crop still held in commercial hands. This cotton will need to move to spinners or be sold to the Reserve before new crop starts to arrive. Secondly, as we discussed earlier, unsold stocks of imported cotton in Chinese-bonded warehouse are at a record, and storage limits have reached capacity. These stocks, plus a sharp increase in Chinese cotton imports in 2018/2019, could reduce new cotton import demand and delay Reserve purchases at the same time consumption is weaker.

The US export requirement is a real burden on world trade. The USDA has world trade outside of China shrinking in 2018/2019, while any Chinese expansion is in doubt. The prospect of a 21-23-million bale US crop is now a possibility, and counting carryover of at least five million bales, we are looking at a potential supply of 26-28 million bales. Domestic use of 3.1 million bales and a surplus of near 23 to 25 million bales exist. We have outlined the challenge for exports above 14 million bales without some extraordinary conditions. The lack of a US or regional consumption base without a solid set of incentives to use US cotton in place, has us concerned about exports. No major new commitment to US textile and

apparel manufacturing has been made in 20 years, which would have increased overall consumption on an ongoing basis. The same is true in Brazil where the local economic growth in the same period has not benefited the local industry due to government corruption and bureaucratic regulations that caused the industry to shrink while Chinese imports dominate the local market. This means trouble for the world's two largest cotton exporters who are both in need of a local and regional robust consumption base. So far, no major commitment from a brand or retailer has arisen to reverse the trend, and a repetition of the China model outside of China is still the current feature.

The buildup to the Trump/Xi Jinping meeting appeared to include some moves to entice US President Trump to soften his stance. One of the cards played by China at every meeting has been to hint at large purchases of US Agriculture products. They then purchase some token volume as a sign of what could come. Each of these efforts appears to have worked, given the importance to the US farm sector in keeping the talks moving and halting the issuance of new tariffs. As of late Friday, US exporters announced China had purchased 544,000 tons of US Soybeans for immediate shipment. Soybeans remain at the forefront of the trade dispute, given the political sensitivity in the US, and China's attempt to influence decisions. Then came the Saturday lunch between US President Trump and Xi Jinping. The result was that Trump said that no additional tariffs would be placed on Chinese imports, which allowed the Chinese to avert 70 billion in new tariffs. In addition, he said the US would soften its stance on sales of US technology to Huawei. US President Trump then told the press that "Xi Jinping had promised to purchase tremendous amounts of US Ag products in exchange, and the US would be providing a list of what we would like them to buy." Then in turn the US/China trade talks would continue.

Does this not sound like a repeat of the dinner meeting in Argentina in December, when the US side announced that China would buy a tremendous volume of US Ag products immediately? The Chinese release of the meeting never acknowledged this, and no major purchases occurred. Thus, either the US side overstated the Chinese commitment or misunderstood a "perhaps" as a solid commitment, or the Chinese issued a vague promise that was never fulfilled. Again, the Chinese press coverage of the dinner only said that the US President hoped China would import more US goods as part of the truce. These conditions suggest a lot of uncertainty around possible Chinese purchases of US Ag products during the trade talks. It also certainly gives the impression that the Chinese have

again used the politically important US farm sector as a tool to avoid the new tariffs and again drag the talks along. The relaxation of restrictions on Huawei will draw domestic criticism. A bill has been introduced in the Senate to remove the ability of the President to influence any Huawei restrictions.

As a result of the meeting, it appears that the 350 billion USD of Chinese imports that could have been hit by a new tariff will continue to flow into the US at the MFN duty rates. This includes textiles and apparel. The US Corporate lobby was successful in obtaining a delay. For cotton, it means the unfettered flow of cheap, subsidized Chinese man-made fiber products into the US at prices undercutting cotton use. This should provide some comfort to the Chinese textile/apparel exporter in the short term and could stabilize order flow. The full positive impact of this may be limited by the stockpiling of orders that had occurred in fears of the additional tariffs. Thus, a positive influence on near-term Chinese cotton consumption is possible. The issue of removing the 25% tariff on US

cotton does not yet appear in the discussion. The State Trading groups could be allowed to buy US cotton exempt from the duty, and Reserve purchases for restocking purposes are possible. With cotton having no clout in Washington, it's just not clear if Chinese purchases of US cotton in any volume will be included in any purchases. In reality, without a solid outline of purchase commitments, the entire meeting could again result in just talk and delay and no action.

The CFTC data on Friday showed that, as of Tuesday, the managed funds held a new all-time record short in cotton of 37,460 contracts. We have expected this short could near the 50,000-contract level. Many of the managed funds are driven by algorithmic programs. These include those driven by headlines and tweets. Thus, the weekend headlines may be enough to again spark a rally in ICE futures. The key will be how the spinners confidence is impacted, and if any real purchases of US cotton occur by Chinese groups. We remain suspicious that, with the exception of the stage being set for more talks, no real change has occurred.

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Eddie Jernigan



Register for Research  
info@JerniganGlobal.com



ed.j@jernigancg.com



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